

LKAS 37

Provisions, Contingent Assets & Liabilities

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Reading for MBA (PIM), CA and CIMA Prize Winner



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Accounting Standards

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LKAS 37 PROVISIONS, CONTINGENT LIABILITIES & CONTINGENT ASSETS

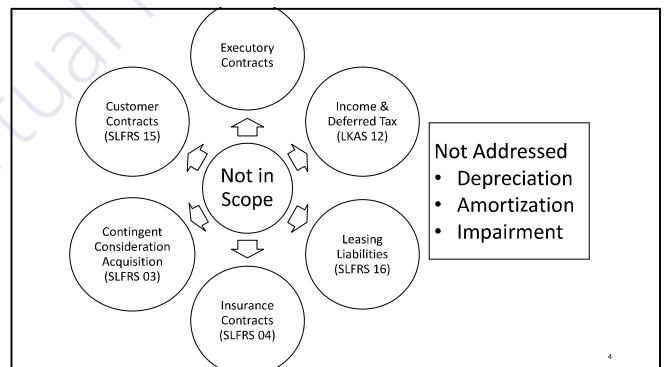
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Liabilities not within the scope of LKAS 37?

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A General Norm Required to Remember in Learning this Standard

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Probable



>50%
(Not closer to 100%)

Virtually
Certain



Closer to 100%

Possible



<50%
(Not closer to 0%)

Remote



Closer to 0%

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Liability (New definition from Con. Framework)

Present obligation

Transfer economic resources

Past events

Cannot avoid

Key Points

A present obligation of the entity to transfer an economic resource as a result of past events

An obligation is a duty or responsibility that the entity has no practical ability to avoid

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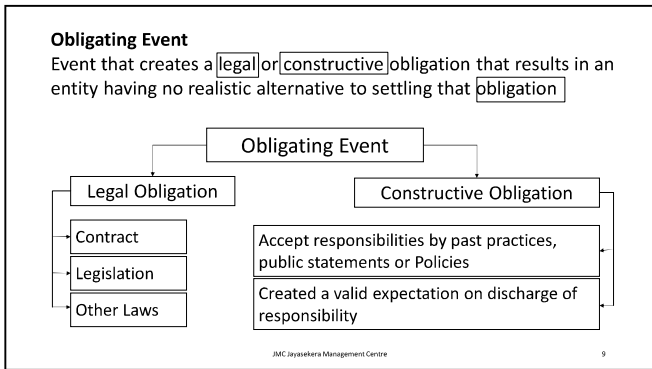
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Past Event

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Probable outflow of economic resources

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Probable Outflow of Economic Benefits

Probable means more likely to occur than not to. That means more than 50% chance is there to occur.

Outflow of economic resources means outflow of assets such as cash or other assets in settling the liability

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Provisions

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Provisions

Provision is a liability with uncertain timing or amount

Provisions

Liability with

Uncertain timing or

Uncertain amount

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Recognition of Provision

When All 03 Criteria Met

Present Obligation (Legal or Constructive) as a Result of a Past Event

Probable Out Flow of Economic Benefits

Amount can be Estimated Reliably

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Measurement of Provisions

Best estimate of expenditure required to settle the present obligation measured at end of reporting period

Measurement

Individual Most Likely

- Similar Transaction Value
- Expert's Reports
- Events After Reporting Date

Expected Value

- Probability X Outcomes

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How to measure the best estimate (most Likely)

Methods used

Similar transactions value

Tax consultant's fee provided based on last year bill

Independent expert's report

Consultancy fees measured using an expert's reports

Events after reporting date

Tax consultant's fees based on actual bill received after the reporting date

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Expected Value Method

If provision measurement involves large population of items, use EXPECTED VALUE

Expected Value = Cumulative of different outcomes into probabilities
 (Outcome A X Probability A) + (Outcome B X Probability B) etc.

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Question 01

Mention whether following liabilities are legal liabilities or constructive liabilities

1. Bank Loans	
2. Trade Creditor	
3. Preference Shares	
4. EPF Liabilities	
5. Emp. Gratuity	
6. Warranty	
7. Bonus Payable	

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Question 01

8. Accrued Electricity	
9. Rent Payable	
10. Directors have decided to close down a sector, however no one has been informed the decision.	

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Question 02

Mention whether following liabilities are provisions or not?

Detail	Uncertain Period	Uncertain Amount	Provision or Not?
1. Trade Creditors			
2. Accrued Water Bill			
3. Employee Gratuity			
4. Warranty			
5. Building Rent Payable			

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Question 03

Mention whether these liabilities can be recognized or not?

Description	Present Obligation as a result of a Past Event	Probable outflow of Economic Benefits	Measured Reliably
1. Accrued			
2. Bonuses paid out of Profits			
3. Computers sold for the First time with 06 months Warranties			

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Detail	Present Obligation as a result of a Past Event	Probable outflow of Economic Benefits	Measured Reliably
4. Compensation Payable to a customer			
5. Warranties provided for Refridgegetaror by Abans.			
6. Case filed by an Employee against the company			

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Detail	Present Obligation as a result of a Past Event	Probable outflow of Economic Benefits	Measured Reliably
7. Directors have decided to Close down a Section and it has not been informed to Employees			
8. Directors have decided to Close down a Section and it has been informed to Employees			

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Question 04

Senox sell goods with 06 months warranty. If all the sold goods were to have a minor defect, the repair cost will be Rs.1Mn. The probability to have a minor defect is 20%. If all the sold goods were to have a major defect, the repair cost will be Rs.4Mn. The probability to have a major defect is 5%. 75% of the goods will not have any defect. Calculate the expected value

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Question 05

Lucky Ltd. has constructed a building. The financial year ends on 31st March. The amount payable to contractor depends on the percentage completed of the building. The percentage completed is determined using an independent engineer. Engineer has confirmed a completion of 50%. The total project value is Rs.14Mn. Company has already paid Rs.7Mn to the contractor. Calculate the amount payable to the contractor as at the year end.

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Question 06

In which of following situations a provision is required in Financial Statements as per LKAS 37 Provisions, Contingent Liabilities and Contingent Assets Standard?

- A – Selling a product with a One-year Warranty
- B – Depreciation of Property, Plant and Equipment
- C – Accepting the defective goods to be repaired based on past practice.

- I. Only A
- II. Only B
- III. A and B
- IV. A and C
- V. A, B and C

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Question 07

Gamage Ltd. is selling goods with a one-year warranty. The provision for warranty as at 01st April 2019 was Rs.525,000. The warranty paid during 19/20 was Rs. 375,000 and warranty expense provided was Rs.650,000. How much is the warranty provision as at 31st March 2020?

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Question 08

Select the correct alternative in brackets to indicate the features of a provision

Feature	Provision	Other Liabilities
Present Obligation (Yes/No)	_____	_____
Amount Payable (Certain/Uncertain)	_____	_____
Settlement Period (Certain/Uncertain)	_____	_____

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Contingent Liabilities

Contingent Liability

Possible obligation

Past events

Existence

Uncertain,
uncontrollable future
events

Or

A Liability where

Outflow is not
probable, or

Measurement is
not reliable

Contingent Liability

A possible obligation arising from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity or

A present obligation that arises from past events but is not recognized because

- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or
- The amount of the obligation cannot be measured with sufficient reliability

Contingent liability examples

Pending cases filed against the company

The cases filed against the company are possible obligations as the court decision is not given. Whether, the company become liable or not depend on the decision of the court which is not within the control of the entity

Bank guarantees given by the company

Bank guarantees given does not create a present obligation for company to settle loan taken by the other entity. However, it's possible obligation, as if the other entity default the loan the company has to settle it. Defaulting the loan or not depend on other entities future actions, which is not within the control of the entity

Contingent liability examples

Company agreed to pay 10% of the next profits to a consultant. However, company's operational cost increased significantly. Next year will be a loss making year.

The outflow of economic resources depend on profitability of the company. As a result of the current status, it is not probable. Therefore, the liability will become a contingent liability

Company has provided warranties for a new product for the first time. Company is unable to reliably measure the warranty provision.

Since the liability cannot be measured reliably, warranty will be treated as a contingent liability.

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Contingent liability accounting treatment

X Recognize

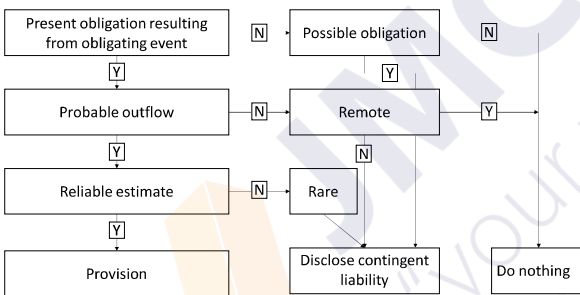
Disclose
(Unless, Remote)

- Nature
- Financial estimate
- Indication on uncertainty or timing of outflows
- Possibility of reimbursement

Contingent liability's probability of outflow of economic resources shall be checked frequently. If it's outflow become probable, a provision shall be recognized.

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Contingent liability decision tree



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Contingent Assets

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Contingent Assets

- Possible asset
- Past events
- Existence
- Uncertain, uncontrollable future events

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Contingent Asset

A possible asset arising from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity

Contingent Asset recognition and disclosure

X Recognize

Disclose (If, probable) → Nature Financial Estimate

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Contingent assets examples

Pending cases filed by the company
 The cases filed by the company claiming a compensation are possible assets as the court decision is not given. Whether, the company receive the compensation or not depend on the decision of the court which is not within the control of the entity

Warranty claimed by the company
 There can be situation such as company claimed manufacturer warranty for defect in a concrete mix, and whether the warranty claim received or not depend on an independent expert's report which is not within the control of the entity

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